



# Kentucky Tax Alert



A KRC PUBLICATION FOR THE TAX PROFESSIONAL

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## A Review of Tax Law Changes Enacted by the 2002 General Assembly

(This legislative summary was compiled by the staff of KRC's Division of Tax Policy)

*NOTE: This summary of legislation enacted by the 2002 General Assembly is intended to present only general information concerning the major provisions of the legislation and should not be construed to represent a complete analysis or specific interpretations of the law changes. Information that is more specific will be provided to taxpayers as the legislative changes are implemented. Full text of enacted bills is available on the legislative home page [www.lrc.state.ky.us](http://www.lrc.state.ky.us).*

The 2002 Kentucky General Assembly created, amended, or repealed numerous statutes. A total of 1,169 bills and 574 resolutions were introduced. Of this total, 368 bills became law for an enactment rate of 26.86 percent.

Thirty-three bills and resolutions had substantive tax implications. The tax portion of each bill is described in this review. Effective dates are shown when specifically stated in the legislation. Otherwise, the changes are effective July 15, 2002.

### Tax Amnesty

**When**—A Tax Amnesty Program will be offered during the fiscal year ending June 30, 2003, for a period of not less than 60 nor more than 120 days. KRC plans to conduct the program during the fall of 2002.

**Who**—All taxpayers who pay their taxes directly to KRC qualify for tax amnesty except those on notice of a criminal investigation or who are the subject of any criminal litigation for nonpayment, delinquency, evasion, or fraud in relation to any federal or state taxes.

**Taxes Included**—All taxes under the direct administrative jurisdiction of KRC except ad valorem taxes levied on most real property, motor vehicles, and motorboats (collected by the county clerk), and personal property payable to local officials (i.e., furniture and fixtures, inventory).

**Tax Periods Included**—All tax periods beginning on or after December 1, 1987, and ending prior to December 1, 2001. (Prior amnesty covered periods ending prior to December 1, 1987.)

#### Amnesty Incentives

- All eligible taxpayers will pay only the tax due for all eligible tax periods.
- All interest will be waived.
- All penalties and cost of collection fees will be waived.

#### After Amnesty

- The current 20 percent Cost of Collection Fee will be increased to 25 percent.
- KRC will be authorized to publish a list of delinquent taxpayers. This list may be published on the Internet or through any medium available. This would be similar to the list of delinquent real property taxpayers which is already required by law to be published in the newspaper.
- Corporate officers will be individually liable for the payment of gasoline and special fuels taxes collected from their customers. This legal liability is already in place for sales and use, withholding taxes, health care providers, and coal severance taxes.
- Individual liability will be imposed on the responsible members and partners of limited liability companies (LLCs) and limited liability partnerships (LLPs) for gasoline and special fuels, sales and use, and withholding taxes, each of which is collected by the business entity for remittance to the commonwealth. This provision will be effective retroactive to July 15, 1994.

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- A \$100 minimum failure to file penalty will be imposed for those taxpayers who fail to file returns after they have been requested by KRC. **(HB 614)**

## General Administration

**Collection of Delinquent Child Support Obligations—**Amends KRS 131.130 to permit KRC to enter into an annual memoranda of agreement with the Cabinet for Families and Children to collect support obligations for up to five years. This legislation also permits KRC to use the same powers, rights, duties, and authority for the collection, refund, and administration of support obligations as is used by KRC for delinquent taxes under KRS Chapters 131, 134, and 135, and as used by the Cabinet for Families and Children for support obligations under KRS Chapters 205 and 405. **(SB 133)**

**CPAs and Attorneys May Act as Agents for Kentucky Permits and Taxes—**Creates a new section of KRS Chapter 352 to allow licensed certified public accountants and licensed attorneys to act as agents for their clients and complete, sign, and submit applications for seller's permits for Kentucky use tax collections, general business licenses, and employer's withholding tax, corporation income tax, and corporation license tax registration numbers. It also amends KRS 139.240 to allow the "agents" to sign an application for a seller's permit on behalf of the owner or business entity, and amends KRS 143.030 to permit the application for a certificate of registration on behalf of an individual or business entity. **(HB 273)**



**Tax Increment Financing (TIF)—**This legislation amends KRS Chapter 65 to include new definitions related to the Kentucky Tax Increment Financing Act. It also provides procedures for determining the state's portion of the incremental state revenue that may be returned to the local development area in order to promote economic development. This bill requires Kentucky Economic Development Finance Authority (KEDFA) approval of industrial revenue bonds if state property taxes are to be reduced. **(HB 372)**

**Taxpayer Information—**Requires KRC to provide an electronic copy of the names and addresses of all persons filing Kentucky resident individual income tax returns by county to the Administrative Office of the Courts for a potential jury pool. The information is subject to the confidentiality provisions of KRS 131.190. **(HB 781)**

## Income Tax

**Filing Extension for National Guard Members and Reserve Members—**National Guard and Reserve members on active duty, and who serve in an area designated as a combat zone by presidential proclamation, are entitled to an extension to file and pay Kentucky income taxes that become due during the period of service. The extension is for 12 months after the expiration of the service in the combat zone. **(SB 178)**

**Skills Training Investment Credit and Other Economic Development Incentives—**KRS 154.12-2084 was amended regarding eligibility criteria for the Bluegrass State Skills training investment tax credit. This change establishes minimum wage and benefit requirements at 150 percent of the federal minimum wage plus benefits of 15 percent of the applicable base hourly wage for 90 percent of the participants if the business is located in a county with an unemployment rate of 15 percent or greater. Also, KRS 154.20-170 was amended to provide that the KEDFA give priority consideration to economic development initiatives in counties with an unemployment rate of 15 percent or greater. **(HB 166)**

**Vouchers for Purchase of Health Insurance—**KRS 141.010 is amended to exclude from income tax any amount paid to provide vouchers for the purchase of health insurance. Employers may deduct the cost of vouchers or similar instruments that provide health insurance coverage to employees or their families. Employees may exclude from gross income the value of any voucher or similar instrument used to provide health insurance. The provisions of HB 280 are effective for taxable years beginning after December 31, 2000. **(HB 280)**



**Economic Development Modernization—**This legislation updates the current economic development tax incentive programs of Kentucky Rural Economic Development Act (KREDA), Kentucky Industrial Development Act (KIDA), Kentucky Jobs Development Act (KJDA), and Kentucky Economic Opportunity Zone (KEOZ). All of these programs were changed to establish wage and benefit thresholds for eligible companies by requiring that within six months after the activation date the approved company shall compensate at least 90 percent of its full-time employees whose jobs were created as a result of the approved project with base hourly wages equal to 75 percent of county or state wages, but no less than 150

percent of federal minimum wages. In addition to the base hourly wage, the approved company must provide employee benefits equal to at least 15 percent of the base hourly wage or provide hourly compensation equal to 115 percent of the base hourly wages. The following specific changes were also made to these programs:

**KREDA**—Added a third eligibility standard for counties to qualify for KREDA benefits which will result in 11 additional counties qualifying;

**KREDA, KEOZ, and KIDA**—Changed the limitation on tax incentives from debt service to approved costs;

**KREDA, KJDA, and KIDA**—Allow, with KEDFA approval, approved companies or their affiliates to impose wage assessments; and

**KJDA**—Reduce minimum jobs for eligibility from 25 to 15 jobs to attract "New Economy" businesses. **(HB 372)**

**Internal Revenue Code Reference Update**—The Internal Revenue Code (IRC) reference date in KRS 141.010(3) is changed to the code in effect on December 31, 2001, for taxable years beginning on or after January 1, 2002. The provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) are included and in effect for 2002 Kentucky returns. HBs 243 and 812 amended KRS 141.050 to provide that changes to federal income tax law made after the IRC reference date contained in KRS 141.010(3) shall not apply for purposes of KRS Chapter 141 unless adopted by the General Assembly.

**Not included** in the code update are the provisions of the "Victims of Terrorism Tax Relief Act of 2001" signed by President Bush on January 23, 2002, and the "Job Creation and Worker Assistance Act of 2002" signed by President Bush on March 9, 2002. **(HB 457)**

**Credit for Qualified Research**—A new section of KRS Chapter 141 was created to allow a credit against individual and corporation income taxes equal to 5 percent of the cost of constructing and equipping new facilities or expanding existing facilities in Kentucky for "qualified research." "Qualified research" is defined to mean qualified research as defined in Section 41 of the IRC. **(HB 525)**

**Revisions to Kentucky Investment Fund Act (KIFA)**—Various sections of KRS 154.20-250 to 154.20-284 were repealed and new sections were created to make the following changes:

1. allow this credit to apply to insurance taxes imposed by KRS 136.320, 136.330, and 304.3-270, and taxes imposed on financial institutions by KRS 136.300 and 136.310 (savings and loan associations) and KRS

136.505 (bank franchise tax) in addition to the current credit against individual and corporation income tax and corporation license tax;

2. changes the time the credit is granted from the time of making the investment in the fund to when the fund has made an investment in a qualified business;
3. provides that the investor may not claim the credit until the tax year following the year in which the credit is granted; and
4. establishes \$3 million as the maximum amount of KIFA credits that may be approved during each of the fiscal years ended 2003 and 2004. **(HB 525)**

**Nonresident Partners of Qualified Investment Partnerships**—KRS 141.206 was amended to exempt nonresident individuals from taxation on distributive share income from a "qualified investment partnership." "Qualified investment partnership" is defined to mean a partnership formed to hold **only** investments that produce income that would not be taxable to the nonresident individual if held or owned individually. **(HB 525)**

## Motor Vehicle Usage Tax

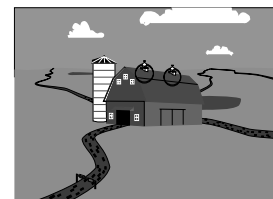
**Loaner or Rental Motor Vehicles**—KRS 138.4605 was amended to modify the taxation of motor vehicles loaned or rented by an automobile dealer to a customer with a vehicle in the dealer's service or repair facility. Such vehicles registered under the program will be subject to a flat \$25 per month tax. This replaces the previous taxation system where tax was based on 6 percent of gross receipts. Administration of the tax is moved from the Transportation Cabinet to KRC. Motor vehicles no longer covered under the loaner permit program will be taxed as all other motor vehicles under KRS 138.450(12). **(HB 325)**



## Property Tax

### Agricultural Exemptions—

This bill expands the definition of agricultural land to include any parcel of at least five acres used for aquaculture (similar to the five acre horticultural qualification) thereby allowing the property to be assessed based upon its agricultural value. **(SB 179)**



### **Training Units/Incentives for County Officials—**

Amends KRS 132.590(3)(c) regarding the issuance of annual training incentive payments for PVAs. This bill will allow the PVA, once reaching four incentive payments, to have the opportunity to remain at this level of payment until departure from the office, and never to exceed four checks per year. This bill provides that PVAs are subject to the same requirements as county officials with regard to attainment of training units and incentive payments. This bill becomes effective July 15, 2002. **(HB 120)**

**Unmined Minerals Property Tax—**This bill provides relief to farmers who hold fee simple interest in their properties, or have retained the mineral rights as well as the surface rights. Currently, unmined minerals (including coal) are severed from the surface estate for many parcels and are assessed separately in all cases. Under HB 243, individuals will not receive an unmined minerals property tax bill if they own the surface real estate and the unmined minerals, they are not engaged in or affiliated with the business of mining, and the property is being actively farmed or managed for timber production. These changes become effective January 1, 2003. **(HB 243)**

**Omnibus Housekeeping Bill—**Updates and clarifies property tax language in several statutes and extends several due dates to the benefit of the taxpayer. All provisions in this bill become effective July 15, 2002, except Section 6, which will become effective January 1, 2003. This KRC initiative accomplishes the following:

1. removes obsolete agency references;
2. extends filing dates for public service companies and financial institutions;
3. removes a conflicting penalty provision for distilled spirits tax;
4. synchronizes dates on which unlisted tangible personal property becomes omitted;
5. extends the protest period for omitted personal property from 30 to 45 days;
6. the amendment to KRS 132.290 makes the property tax interest statute consistent with that of other taxes by requiring interest to accrue on omitted property tax bills to the date the bill is paid. **(HB 448)**

**Fire Department Fees—**This bill specifies that if a fire department collects membership charges or subscriber fees, a fiscal court may adopt an ordinance to add these charges or fees to the property tax bill. It requires the county clerk to add the charge or fee amount to the tax bills of the affected property owners, and requires sheriffs to collect the charges or fees in the same manner as other taxes on the bill. Unpaid charges or fees will bear the same penalty as general state and county taxes, and will result in liens being placed on property for nonpayment. **(HB 483)**



**Foreign Trade Zones—**Amends KRS 132.020 and 132.200 to clarify that favorable property tax rates and exemptions for foreign trade zones (FTZ) are limited only to zones that are established and activated in accordance with U.S. Customs and Foreign Trade Zones Board regulations. HB 715 clarifies the General Assembly's intent to reserve FTZ benefits for businesses that bring foreign commerce through Kentucky. This bill becomes effective July 15, 2002. **(HB 715)**

**Motor Vehicle Ownership—**Amends KRS 186.021, 134.805, and 134.810 to clarify that the owner as defined in KRS 186.101(7)(a) and (c) on January 1 of any year is liable for the property taxes on motor vehicles. The buyer in possession of the vehicle on January 1 is the legal owner for tax purposes, even if the title hasn't been "officially" transferred. Effective January 1, 2003. **(HB 812)**

## **Sales and Use Tax**

**Unenriched and Enriched Uranium—**Effective August 1, 2002, an amendment to KRS 139.470 provides that receipts from the sale of unenriched and enriched uranium purchased for ultimate storage, use, or other consumption outside this state and delivered to a common carrier for shipment outside this state will not be subject to Kentucky sales tax. This exemption applies regardless of whether the carrier is selected by the buyer or seller or an agent or representative of the buyer or seller, or whether the F.O.B. is seller's shipping point or buyer's destination. **(SB 193)**

**Tourism Attraction Projects—**The 1996 Tourism Development Act provided sales tax inducements for a "tourism attraction project" that enters into an agreement with the Tourism Development Finance Authority on or before June 30, 2002. Effective April 11, 2002, an amendment to KRS 148.851 has removed the June 30 deadline of the original legislation. This bill also expands the type of lodging facilities that can be part of a "tourism attraction project." Full service lodging facilities with a minimum of 500 guest rooms that have reconstruction, restoration, rehabilitation, or upgrade costs of more than \$10 million may now qualify as part of a "tourism attraction project." **(HB 372)**

**Cervid Exemption—**Effective July 1, 2002, an amendment to KRS 139.480 codifies a provision originally included in the 2000 budget bill. Members of the genus cervidae (deer and elk) used in an agricultural pursuit for the production of hides, breeding stock, meat and cervid by-products will be exempt from sales and use tax. Water, feed and feed additives, insecticides, fungicides, herbicides, rodenticides, and other chemicals used in this pursuit, equipment, machinery, attachments, repair and



replacement parts, and any materials incorporated into the construction, renovation, or repair of the on-site facilities will be exempt from the sales and use tax. **(HB 517)**

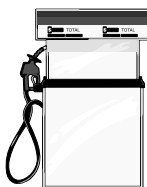
**Mobile Telecommunications Services**—Effective for customer service bills after August 1, 2002, an amendment to KRS 139.100 conforms the taxation of mobile telecommunications services billed in Kentucky to the Federal Mobile Telecommunications Act which Congress passed on July 28, 2000. All states are conforming to this language to ensure that more than one state will not impose a sales tax on the same mobile telecommunications services. At the effective date, mobile phone service charged to a customer with a primary service address in this state will be subject to Kentucky sales tax regardless of where the call originates or terminates. **(HB 634)**



### Miscellaneous Taxes

**Insurance Premium Surcharge**—SB 187 provides that the Department of Insurance shall provide KRC with a list of all Kentucky-licensed property and casualty insurers and the amount of premium collected. KRC shall estimate the premium surcharge due and compare the results of the estimate with the surcharge paid the preceding year and report to the Legislative Research Commission, the Commission on Fire Protection Personnel Standards and Education, the Kentucky Law Enforcement Council, and the Department of Insurance. **(SB 187)**

**Agricultural Gasoline Excise Taxes**—Replaces the current refund system for agricultural gasoline excise taxes with an exemption for this fuel. Agricultural special fuels are already exempt from the tax. However, purchasers of gasoline used in watercraft, aviation, city and suburban buses, taxicabs, and senior citizen transportation must continue to pay the tax and apply for a refund. **(HB 43)**



**Waste Tire Fee**—Extends the "waste tire" fee (which was scheduled to end on July 31, 2002) to July 31, 2006. **(HB 422)**

**Mineral Severance Tax**—Deletes the exemption of tar sands from the mineral severance tax. It provides that the severance tax from tar sands is to be distributed to counties and is to be used for economic development purposes as approved by the Department of Local Government. **(HB 457)**

**Bank Franchise Code Update**—The current IRC reference date for bank franchise tax is updated from December 31, 1997, to December 31, 2001. This amendment will not change the amount of tax owed by a financial institution. Effective for the bank franchise tax return filed for the calendar year ending December 31, 2002. **(HB 531)**

**Dyed Diesel Fuel/Motor Fuel Bonding Requirements**—Amends the definition of "special fuels" to include dyed diesel fuel to allow better tracking of fuel use. The bill also provides that motor fuel dealers may elect to file a financial agreement with KRC not to exceed two months estimated tax liability or \$5,000, whichever is greater, provided that they meet certain reporting and payment requirements. Otherwise, they would continue to file a financial agreement with KRC not to exceed three months estimated tax liability or \$5,000, whichever is greater. **(HB 662)**

### Interim Studies

**Individual Development Accounts**—This resolution directs the Department of Financial Institutions to conduct a study of the establishment of an individual development accounts program in Kentucky. Findings and recommendations must be presented to the Legislative Research Commission (LRC) by October 30, 2003. **(SJR 153)**

**Kentucky Enterprise Zone Program**—The Interim Joint Committee on Appropriations and Revenue will study the Kentucky Enterprise Zone Program and present findings to LRC by December 1, 2002. **(HCR 13)**

**Forest Management**—LRC will study and report to the 2003 General Assembly on state and federal inheritance, property, and income tax policies that discourage good forest management practices. In addition, the study shall identify incentives that would encourage good forest management. **(HCR 13)**



## Notice of Pendency of Class Action Related to Constitutionality of Kentucky Corporation License Tax Scheme

The constitutionality of Kentucky's license tax scheme has been challenged in a lawsuit filed by Illinois Tool Works Inc. (ITW) against the Kentucky Revenue Cabinet (KRC). The style of the action is ***Illinois Tool Works Inc., Individually, and on Behalf of All Other Similarly Situated Taxpayers Denied the Benefits of KRS §136.071 Because Their Commercial Domiciles Are Outside Kentucky v. Commonwealth of Kentucky, Revenue Cabinet and Dana B. Mayton, not individually, but in her capacity as Secretary of the Revenue Cabinet***, Franklin Circuit Court, Division I, Civil Action No. 00-CI-00623.



The Franklin Circuit Court of Franklin County, Kentucky has decided that this action may be maintained as a class action in accordance with Rule 23.01(a) and (b) of the Kentucky Rules of Civil Procedure. Accordingly, ***all corporations who do not have their commercial domicile in Kentucky and who are otherwise subject to the corporation license tax imposed by Section 136.070 of the Kentucky Revised Statutes may be affected by this lawsuit.***

In the action, ITW is asking the court to declare the Kentucky corporation license tax scheme unconstitutional under the United States Constitution's Commerce and Equal Protection Clauses and Section 2, 3 and 59 of the Kentucky Constitution. ITW contends that KRS 136.071 is unconstitutionally discriminatory in that it permits corporations with their commercial domiciles in Kentucky to take advantage of KRS 136.071's provisions in arriving at their Kentucky corporation license tax liability while denying that right to corporations having their commercial domiciles outside Kentucky. ITW further seeks a declaration that all non-Kentucky corporations meeting the criteria of KRS 136.071 be allowed to utilize that statute's provisions in computing their taxable capital for purposes of their corporation license tax liability for all years open to adjustment and be granted tax refunds where appropriate.

It also seeks an injunction barring KRC from enforcing the Kentucky commercial domicile restriction of KRS 136.071.

KRC has denied many of the principal allegations made by ITW and has requested a judgment in its favor. In addition, KRC contends that if KRS 136.071, or some facet of it, is unconstitutional, the statute should be stricken in its entirety, thereby eliminating it from the Kentucky corporation license tax scheme. Furthermore, KRC has filed a counterclaim seeking a declaratory judgment that if refunds are found by the circuit court to be due, the Commonwealth of Kentucky should not be liable for interest on those refunds under KRS 134.590, the applicable refund statute.

The corporations which comprise the class in this lawsuit consist of those corporations subject to the Kentucky corporation license tax which:

- (1) hold or have held, directly or indirectly, stock or securities in other corporations equal to or greater than 50 percent of their total assets; and
- (2) cannot utilize, or have not been able to utilize, the provisions of KRS 136.071 because their commercial domiciles are or have been outside Kentucky.

These corporations include those which have refund claims pending before KRC based on this issue, those which have taken advantage of KRS 136.071 and been assessed by KRC for additional license tax, and those corporations which meet the above criteria and have not filed refund claims.

By virtue of the Franklin Circuit Court's determination that this action may proceed as a class action, ITW shall act as the representative of the above class and its attorneys shall act as counsel for the class ("Class Counsel"). Class Counsel are Bruce F. Clark and Erica L. Horn, Stites & Harbison, PLLC, 421 West Main Street, P.O. Box 634, Frankfort, Kentucky 40602, phone (502) 223-3477, fax (502) 223-4124.

The circuit court's decision that this action may proceed as a class action does not necessarily mean that any declaratory or injunctive relief will be obtained for the class members, because the entitlement of the class to this relief hinges on contested legal issues that will need to be decided by future proceedings in this case. Rather, the circuit court's class action ruling means that ***the final outcome of this lawsuit, whether favorable to the defendants or ITW and***

*(continued on page 7)*

Notice of Pendency (continued from page 6)

***the class it represents, will apply in a like manner to every class member and each class member will be bound by this outcome.***

***The filing and pendency of this action and its certification as a class action does not relieve any class members of their obligations under the law to timely protest any assessment or timely file any refund claim based upon the unconstitutionality of KRS 136.071 or any portion thereof.*** KRS 134.590 requires that

refund claims or applications based upon the unconstitutionality of a statute (and KRS 136.071 in particular) must be submitted to KRC within two years of the payment of the taxes whose refund is being sought and that the pendency of this lawsuit does not relieve a taxpayer of this requirement.



If you are a member of the class described above and do not wish to be included, you must file in writing a request to be excluded from the class with the Franklin Circuit Court no later than July 31, 2002. If you do this, you will not be governed by the outcome of this case.

Any questions concerning the matters described should ***not*** be directed to the Franklin Circuit Court but should ***be directed in writing to Class Counsel***. You may also communicate with Class Counsel by calling Mr. Clark or Ms. Horn at (502) 223-3477.

## Treasury Offset Program Expands

Kentucky has participated in the Treasury Offset Program since February 2000. This program allows for the reduction or offset of federal tax refunds to pay past due, legally enforceable state income tax liabilities. Previously, Kentucky only submitted income tax debts under the primary taxpayer's Social Security number. Beginning February 12, 2002, Kentucky started submitting individual income tax debts under the primary and secondary taxpayer's Social Security numbers.



In addition, as of this February date all eligible withholding tax liabilities are being submitted for potential offset. This means an officer in a corporation or a sole proprietor or partner that has been assessed and/or final noticed may have his federal tax refund offset to pay his or her withholding liability.

Under provisions of this act, states must attempt to notify taxpayers via certified mail of the impending offset of their refund. This notification language is included in the Final Notice Before Seizure letter that is sent to taxpayers.

Eligible debts are submitted on a weekly basis to Financial Management Service (FMS), a bureau of the Department of Treasury. Since Kentucky's participation began in February 2000, almost \$3 million in federal offsets have been collected.

**Kentucky Tax Alert** is a bimonthly publication printed on recycled paper, the costs of which are paid from state funds.

Comments, suggestions and mailing list additions or corrections should be addressed to the Public Information and Communication Services Branch, Revenue Cabinet, Station 14, Frankfort, Kentucky 40620, (502) 564-4592.

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The mission of the Kentucky Revenue Cabinet is to...  
 Provide courteous, accurate and efficient services for the benefit of the Commonwealth and administer Kentucky tax laws in a fair and impartial manner.

**The Kentucky Revenue Cabinet  
 Mission Statement**

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